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RUCNDT/USMISSION USUN NEW YORK 3430

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C O N F I D E N T I A L SECTION 01 OF 03 BEIRUT 000141

SIPDIS

DEPT FOR NEA/ELA

ALSO FOR EEB/ODF DEMARCELLUS

P FOR DRUSSELL AND RRANGASWAMY

STATE PASS USTR

STATE PASS USAID FOR BEVER/LAUDATO/SCOTT

TREASURY FOR PARODI/BLEIWEISS/CORREA

USDOC FOR 4520/ITA/MAC/ONE

NSC FOR SHAPIRO, MCDERMOTT

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SUBJECT: LEBANON: CHATAH FRUSTRATED WITH BUDGET IMPASSE IN CABINET

Classified By: Ambassador Michele J. Sison for reasons 1.4 (b) and (d).

SUMMARY

¶1. (C) In a February 2 meeting with the Ambassador, Finance Minister Mohammad Chatah said he would formally ask the IMF to certify the GOL's fulfillment of the USG gas excise subsidy benchmark, and hoped the USG would use its USD 50 million disbursement to pay off Central Bank of Lebanon Eurobond debt. He noted the GOL would soon execute a debt exchange on more than USD 2.6 billion in debt. He explained the intricacies of the current budget battles in the cabinet over the issue of the Council for the South, and assessed that Amal Party leader Nabih Berri would benefit politically from the conflict, regardless of the outcome. He did not see the absence of a budget having any dramatic effect on the government or the Lebanese economy (The last time Parliament passed a budget was in 2005). Chatah expressed frustration at the lack of transparency in the budget and state institutions like the Council for the South and Higher Relief Council, and wondered how he would fund the budget deficit these entities would generate in 2009 and still meet IMF debt benchmarks.

¶2. (C) Chatah was concerned about potential violence in the Palestinian refugee camps following the conflict in Gaza, and wondered if Lebanon could count on help from the Syrians to dismantle the armed Palestinian bases outside the camps. He was skeptical of Syria's commitment to a reconciliation with Saudi Arabia, assessing that the Syrian leadership was biding its time until after the Israeli elections and until it receives a clearer signal from the new U.S. administration on its Middle East policy. Chatah stressed that Lebanon should seek a way forward in the international context, engaging with Israel and presenting an concrete alternative to Hizballah's security strategy. End summary.

U.S. CASH TRANSFER
CONDITION MET

¶3. (SBU) The Ambassador, accompanied by EconOff, called on Finance Minister Chatah in his ministry office in downtown

Beirut February 2. The ministry's UNDP Project Manager Chris de Clercq also attended the meeting. The Ambassador congratulated the minister on Lebanon's fulfillment of one of the USG Paris III budget support conditions, by approving a floor on the gasoline excise tax. Chatah said the ministry had informed the IMF informally of its action, which was one of the measurable benchmarks in Lebanon's first Emergency Post-Conflict Assistance (EPCA) agreement, but had not yet done so formally. He assured the Ambassador that his team would seek IMF certification of the measure, and reiterated his earlier request that the USG USD 50 million disbursement be used to pay off Central Bank-held Eurobonds, instead of low-interest World Bank debt. Chatah added that his ministry would soon choose banks to participate in the roll-over of more than USD 2.3 billion in government debt plus interest.

BUDGET WOES:

NO SHORT-TERM CRISIS, BUT DEBT BURDEN WORRISOME

¶4. (C) Chatah told the Ambassador he was hopeful, but not certain, that the heated debate holding up the passage of the 2009 budget could soon be resolved. He explained that the controversy resulted from Prime Minister Siniora's demands to cut the budget of the Council for the South, a proposal vehemently opposed by Parliament Speaker Nabih Berri. (Note: The Council for the South, created in the 1970s, was intended to provide assistance to those affected by Israeli attacks or occupation in southern Lebanon. Still in existence today, it has evolved into an instrument of political patronage for Berri. While politicians call regularly for its abolition,

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its continued operation is due largely to the existence of other sources of patronage, the Fund for the Displaced, seen as Walid Jumblatt's patronage instrument, as well as the Council for Development and Reconstruction (CDR) and the Higher Relief Council (HRC), both seen as patronage war chests for the Prime Minister. All four funds fall under the control of the Prime Minister's office. End note.)

¶5. (C) While the PM proposed to slash the Council's budget, said Chatah, he also refused to disburse money previously appropriated to the Council until he saw an itemized plan for how the money would be spent. Chatah acknowledged that the projects of the Council have been extremely "fuzzy" and highlighted the opacity of the Council's accounting. Nonetheless, he also assessed that the only one to benefit from this battle would be Berri, who is seen as standing up for the south and the Shia, against a seemingly avaricious Sunni PM. Moreover, admitted Chatah, Siniora has been less than transparent in his management of certain funds, which Berri has turned to his advantage. "The Prime Minister trusts himself more than he trusts the system," said Chatah. "He does things on his own and we pay a political price." Chatah said the PM considered it a matter of personal pride that the HRC does not appear anywhere in the budget, not even the salaries of HRC staff. Nonetheless, noted Chatah, the HRC was set to add an astronomical USD 300 million to the GOL's deficit in 2009, because of its diversion of Saudi donations for off-budget projects. He also noted that none of CDR's foreign donations are accounted for in the budget.

¶6. (C) Chatah believed, however, that the budget battle would have little short-term effect on the GOL and the Lebanese economy, since current spending is tied to the 2005 budget (the last one passed by parliament), which means the GOL should have enough funds to cover debt service, salaries, and everyday expenses, while new initiatives would have to wait. (Note: The GOL has functioned on this equivalent of a continuing resolution for the past three years. End note.) He was very worried about the 2009 deficit, saying if he could find no money to cover the HRC shortfall and any extra Council for the South spending, he would be forced to issue more debt, which would push Lebanon's national debt above its current debt-to-GDP ratio, in contravention of IMF EPCA

guidelines. He pondered the possibilities for raising taxes, particularly customs or interest taxes, since the GOL had rejected a call to raise the value-added tax (VAT).

¶ 7. (C) The Ambassador inquired about the defense budget, and Defense Minister Murr's reassurances that he would receive USD 100 million in the budget to refurbish 56 M60 tanks in Jordan for shipment to the Lebanese Armed Forces (LAF). Chatah said he had received no such request from Murr, and at this point there was no funding for it in the budget.

PALESTINIAN CAMPS:
LITMUS TEST FOR SYRIANS

¶ 8. (C) The Ambassador asked Chatah if he was concerned about potential problems in Lebanon's Palestinian refugee camps following the recent Gaza conflict. Chatah stressed that weapons smuggling and violence in the camps have worried him for several years, and said the camps are always fertile ground for unrest. He noted that the President and Defense Minister had discussed the issue of the Palestinian armed bases outside the camps during their trips to Syria. Chatah said Syrian assistance in closing the bases would show that Syria is serious about building a bilateral relationship with Lebanon, and could serve as a litmus test for how things will proceed from here.

¶ 9. (C) Chatah was skeptical the proposed Saudi-Syrian reconciliation would move forward, saying the Syrians had not made a firm decision to pursue it. They are biding their time, he said, until after the Israeli elections and after

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they see clear signs of how the new U.S. administration plans to deal with them.

TALKS WITH ISRAEL:
MAKING MARCH 14'S STRATEGY REAL

¶ 10. (C) Chatah stressed the importance of Lebanon taking part in an international process to forge a peaceful path forward in the region. He hoped that with help from the international community, Lebanon might be able to engage in talks with the Israelis, perhaps in the context of a "Madrid II" international Arab-Israeli peace effort. This, he claimed, would be the only way to discount Hezbollah's arms as a defense strategy, by making a peaceful way forward for Lebanon, in an Arab or international setting, seem "real" to the Lebanese people.

COMMENT

¶ 11. (C) We find Siniora's conflict with Berri perplexing and counterproductive for his March 14 coalition with elections approaching. Chatah, previously Siniora's closest advisor at the Grand Serail, was visibly frustrated with Siniora's delaying the budget on account of the Council for the South, as well as his creative bookkeeping in the other funds under the PM's supervision. While Chatah saw Siniora's attack as strengthening Berri, MP Robert Ghanem, in a February 3 meeting with DCM, pointed out that the conflict might leave Berri seen as weak and strengthen Hezbollah as a representative of the Shia. Ghanem suspected Siniora might be trying to sabotage the budget, in an attempt to keep spending at 2005 levels, a theory we have heard from several interlocutors, given Siniora's reputation for tight-fistedness as a former finance minister. As Ghanem pointed out, recent cabinet decisions provided a vote of confidence for the Council for the South and the Fund for the Displaced, stipulating that both funds are to remain open until they finish their programs. In this political environment, and with many more issues awaiting the cabinet and the parliament before the elections, we wonder what

upside Siniora sees from taking on Berri now. End comment.
SISON